United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

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B/ps

United States Court of Appeals

FOR THE SECOND CIRCUIT

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECUPITIES INVESTOR PROTECTION CORPORATION,

Plaintiffs-Appellants,

—against—

TOUCHE ROSS & CO.,

Defendant-Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

ON REMAND FROM THE SUPREME COURT
OF THE UNITED STATES

BRIEF FOR APPELLEE

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United States Court of Appeals

FOR THE SECOND CIRCUIT

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Plaintiffs-Appellants,

—against—

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APPEAL FROM THE UNITED STATES DISTRICT COURT
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ON REMAND FROM THE SUPREME COURT
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BRIEF FOR APPELLEE

PRELIMINARY STATEMENT

This case is now on remand to this Court from the Supreme Court of the United States, which held (in reversing this Court) that plaintiffs-appellants Edward S. Redington (the "Trustee"), as Trustee for the liquidation of the business of Weis Securities, Inc. ("Weis"), and Securities Investor Protection Corporation ("SIPC") may not assert any rights of action based upon Section 17 of the Securities Exchange Act of 1934 (the "1934 Act"). Defendant-appellee Touche Ross & Co. ("Touche Ross") submits this brief on the separate appeals by the Trustee

and SIPC from Judge Inzer B. Wyatt's order and judgment (413a-414a[1]) in the District Court dismissing their complaint (5a-9la), and addresses, pursuant to this Court's letter request of September 12, 1979, the issues to be determined on the remand.

The Trustee has submitted a brief on the remand asserting that the District Court erred in dismissing his common law claims for lack of subject matter jurisdiction thereof. As demonstrated hereinafter, the arguments asserted by the Trustee are totally lacking in merit and must be rejected. Therefore, in No. 77-7183 (the Trustee's appeal), the order and judgment of the District Court are correct as to the Trustee and should now be affirmed.

SIPC has not submitted any brief on the remand, inasmuch as all of the issues that it originally raised in this Court have been disposed of adversely to it by the Supreme Court's decision, either directly or by necessary implication. Therefore, in No. 77-7186 (SIPC's appeal), there are no remaining issues on remand and the order and judgment of the District Court also should now be affirmed as to SIPC.

COUNTER-STATEMENT OF ISSUES FOR REVIEW ON REMAND IN NO. 77-7183

1. Did the District Court correctly hold, with respect to the Trustee's common law claims of negligence, accountants' malpractice, breach of contract and breach of warranty, that its plenary jurisdiction (unlike that of a Chapter X reorganization court or a federal equity receivership court) is limited by Section 23 of the Bankruptcy Act, as incorporated into the Securities Investor Protection Act of 1970 by Section 6(c)(1) thereof, and therefore that it is without subject matter jurisdiction of those claims?

---

[1] Page references followed by "a" are to the Joint Appendix. References to "Tr. Br." are to the Trustee's brief on this remand.

2. Did the District Court correctly hold, that by filing proofs of claim in the proceeding to liquidate the business of Weis under the Securities Investor Protection Act of 1970, Touche Ross did not "consent" to the jurisdiction of the District Court in this separate plenary action which the Trustee subsequently commenced on unrelated common law claims?

3. If the District Court is reversed in any respect, should not proceedings in this action on the Trustee's common law claims be stayed pending final determination of an earlier-commenced State Court action brought against Touche Ross by the Trustee on exactly the same common law claims?

COUNTER-STATEMENT OF THE CASE

A. The Nature Of The Case

The Trustee, who was appointed and is acting pursuant to the Securities Investor Protection Act of 1970 ("SIPA"),[2] is liquidating the business of Weis, a defunct brokerage firm which collapsed in May 1973. This action is the second of two separate, but practically identical, plenary actions commenced by the Trustee and SIPC against Touche Ross. The first action (the "State Court Action"), which is presently proceeding, was commenced in the New York State courts almost a year before this action and involves exactly the same parties and seeks exactly the same relief as does this action.

Both the State Court Action and this action arise out of the liquidation of Weis and seek to impose liability of

[2] After the dismissal of this action by the District Court, both SIPA and the Bankruptcy Act were amended in 1978. Securities Investor Protection Act Amendments of 1978, Pub. L. No. 95-283, 92 Stat. 249 (1978); Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978). Unless otherwise stated, references herein are to those acts prior to such amendments.

over $65,000,000 upon Touche Ross, a firm of certified public accountants, by reason of its work in connection with certain financial statements (the "1972 Weis financial reports") of Weis for periods ending May 26, 1972, approximately a year before the Weis collapse.

In this action, the Trustee and SIPC allege the same state-created, common law claims of negligence, accountants' malpractice, breach of contract and breach of warranty as previously alleged in the State Court Action. Although the complaint in this action also purports to assert on behalf of both the Trustee and SIPC federal claims based on Section 17 of the 1934 Act—claims which the District Court dismissed, but which this Court upheld by a 2-1 majority, 592 F. 2d 617 (April 21, 1978)—the Supreme Court has now held (in reversing this Court) that the Section 17 claims fail to state a claim upon which relief can be granted. 99 S.Ct. 2479 (June 18, 1979).

Since the federal claims of the Trustee and SIPC have been definitively held to be without merit, pendent jurisdiction over their common law claims necessarily is lacking. Therefore, since SIPC has expressly abandoned any contention that another jurisdictional basis exists for its common law claims,[3] the primary issue on this remand is whether there is any basis for subject matter jurisdiction over the Trustee's common law claims.

The Trustee asserted below and maintains here (despite Judge Wyatt's rejection of his assertions) that the District Court has Bankruptcy Act jurisdiction over those claims. It is Touche Ross' position that Judge Wyatt

[3] SIPC contended below, but in its opening brief on this appeal (p. 5 n.) expressly abandoned the contention (which Judge Wyatt had correctly rejected), that diversity jurisdiction exists with respect to its common law claims.

correctly rejected the Trustee's arguments, and that this Court must affirm.

However, should this Court hold that there is subject matter jurisdiction over any of the Trustee's common law claims, the existence of the State Court Action, and the assertion therein by the Trustee and SIPC of the identical common law claims, raises a secondary issue which was asserted by Touche Ross below (as well as in the earlier arguments to this Court) and which should now be decided by this Court. That is whether, particularly in this day of over-crowded court dockets, and over-burdened and too-limited judicial resources, the Trustee should be permitted to proceed at the same time with both this action and the identical State Court Action. Touche Ross' position is that he should not and that proceedings in this action on the Trustee's common law claims should be stayed pending final determination of the State Court Action.

B. The Course Of Proceedings Herein Prior To This Remand

This action was commenced on April 30, 1976 (1a, 131a). On September 15, 1976, and prior to answer, Touche Ross moved to dismiss the action for failure to state a claim upon which relief can be granted and for lack of subject matter jurisdiction, and for related relief (2a, 127a-128a).

On March 1, 1977, Judge Wyatt issued his opinion, reported at 428 F.Supp. 483, holding that plaintiffs' Section 17 claims fail to state a claim for relief and that the District Court lacks subject matter jurisdiction (including the Bankruptcy Act jurisdiction here claimed by the Trustee) over plaintiffs' common law claims (3a, 391a-

412a). On March 15, 1977, Judge Wyatt signed the order dismissing the complaint and this action, and judgment was entered thereon (3a, 413a-414a).

The Trustee and SIPC filed their separate notices of appeal on April 13 and April 14, 1977 (3a-4a, 415a-418a). On April 21, 1978, this Court (Lumbard and Timbers, CJJ., comprising the majority; Mulligan, CJ., dissenting) reversed in part the District Court's decision, and held that the Trustee as bailee of the property of Weis customers could assert an implied private right of action under Section 17 of the 1934 Act on behalf of those customers whose property he was unable to return, and that SIPC could assert such an implied right of action as subrogee of Weis customers whose claims had been satisfied from SIPC funds. 592 F.2d 617. The Court, however, declined to pass upon Judge Wyatt's holding that there is no Bankruptcy Act jurisdiction over the Trustee's common law claims, with the majority stating that "[b]ecause of the view we take of this case, we need express no opinion as to the scope of bankruptcy jurisdiction in SIPA receivership cases". *Id.* at 619 n.3.

Touche Ross petitioned the Supreme Court for certiorari to review this Court's decision, and the Trustee and SIPC filed separate cross-petitions. Touche Ross' petition, which sought review of this Court's decision upholding plaintiffs' purported federal claims under Section 17, was granted, *Touche Ross & Co.* v. *Redington,* 439 U.S. 979 (1978), and the Supreme Court thereafter reversed and remanded for further proceedings consistent with its opinion. 99 S.Ct. 2479 (June 18, 1979). The Trustee's cross-petition, which sought review with respect to the Bankruptcy Act jurisdiction issue, and SIPC's cross-petition, which sought review with respect to one aspect of the Section 17 issue, both were denied. 99 S.Ct. 3095, 3096 (June 25, 1979).

THE FACTS

The critical facts and their context are not adequately set forth in the Trustee's brief, and therefore are set forth here.

A. The Commencement Of The State Court Action

On July 3, 1975, the Trustee and SIPC commenced the State Court Action in the Supreme Court of the State of New York, County of New York, under the title (which is the same as the title of this action) *Edward S. Redington, as Trustee for the liquidation of the business of Weis Securities, Inc., and Securities Investor Protection Corporation* v. *Touche Ross & Co.* (Index No. 13996/76) (131a, 137a-138a).[4] The parties to the State Court Action are the same as the parties to this action and, as shown more fully hereinafter, the complaint in the State Court Action (139a-166a) asserts identical factual allegations and identical common law claims, and seeks identical relief, as does the complaint here.

B. The Commencement Of This Action

On April 30, 1976, almost ten months after they had commenced the State Court Action, the Trustee and SIPC commenced this action (1a, 5a-91a, 131a).

C. The Complaint Herein

1. GENERALLY.—The complaint contains 14 separate so-called "causes of action", the first six asserted by the Trustee and the other eight asserted by SIPC. The Trustee's second through sixth "causes of action" are his common law claims that raise the questions now before this Court on remand. The Trustee's first, and SIPC's first

[4] As Judge Wyatt noted, the State Court Action "has a 1976 number because the first paper filed in the action was in 1976" (393a).

four, "causes of action", which are their now untenable purported federal (Section 17) claims, raise no issues here. SIPC's fifth through eighth "causes of action", which are its common law claims as to which there is concededly no subject matter jurisdiction, also raise no issues here.

2. THE PARTIES.—The Trustee was allegedly "duly appointed" by order of the District Court dated May 30, 1973 (Comp. ¶ 5).[5] Touche Ross is alleged to be "a partnership of certified public accountants" which was engaged by Weis in 1969 as "its independent certified public accounting firm" and continued to act as such "until about May 1973, when the forced liquidation of Weis commenced" (Comp. ¶7).

3. THE TRUSTEE'S COMMON LAW CLAIMS.—The complaint contains a group of so-called "common" allegations (Comp. ¶¶ 8-31) which set forth the alleged factual basis for, and are expressly realleged in their entirety in, each of the complaint's 14 "causes of action". The "common" allegations assert that Weis was a "broker-dealer in securities" registered with the SEC and a "member" of the New York Stock Exchange (the "Exchange") (Comp. ¶ 8); that events which had "come to light" in April and May 1973 by reason of "separate investigations by the Exchange and the SEC" resulted in "Weis' forced liquidation under [SIPA]" (Comp. ¶ 13); and that on May 30, 1973 "the liquidation of Weis was ordered [by the District Court]" (Comp. ¶ 14).

The "common" allegations also assert that five Weis officers (the "Weis Five") had misstated the financial condition and results of operations of Weis in the 1972

[5] The reference "Comp." is to the complaint in this action, which is reproduced at 5a-91a.

Weis financial reports, and had made it appear therein that Weis had pre-tax earnings for the fiscal year of $1,700,000, whereas Weis actually had suffered losses in excess of $1,500,000. Touche Ross allegedly performed its audit of the 1972 Weis financial reports in a "negligent, reckless, careless, unskilled and grossly negligent manner", and therefore not only failed to discover the misstatements but also improperly certified that the 1972 Weis financial reports fairly and accurately presented the financial condition of Weis in accordance with generally accepted accounting principles. It also is alleged that if Touche Ross had discovered the misstatements in the 1972 Weis financial reports, Weis' declining financial position and the waste of its assets would have been revealed earlier, remedial action such as a change in the Weis management or merger with another firm could have been taken, the forced liquidation of Weis could have been averted or its adverse consequences reduced, and the losses here sued for would not have occurred (Comp. ¶¶ 9-31).

On the basis of the foregoing, the Trustee asserts (in addition to his now-untenable federal claim under Section 17), five separate common law "causes of action" for accountants' negligence and malpractice, breach of contract and breach of warranty, and seeks to recover from Touche Ross damages of $51,000,000 (Comp. ¶¶ 32-49).[6]

4. THE TRUSTEE'S ALLEGATIONS OF JURISDICTION OVER HIS COMMON LAW CLAIMS.—The complaint asserts that subject matter jurisdiction over the Trustee's common law claims exists by virtue of "principles of pendent jurisdiction" (Comp. ¶ 2)—an assertion which is now

[6] SIPC's four common law "causes of action", as well as its four now-untenable federal claims under Section 17, also are based on the "common allegations" (Comp. ¶¶ 50-85).

clearly erroneous, since the Supreme Court has held that the Trustee cannot assert any federal claims under Section 17 of the 1934 Act, and since pendent jurisdiction therefore does not attach to his common law claims. The complaint also asserts (and it is this assertion which presents the issues raised by the Trustee on this remand) that jurisdiction of the Trustee's common law claims is provided by "Sections 2a(7), 102 and 115 of the Bankruptcy Act (11 U.S.C. Sections 11a(7), 502 and 515)", together with "Section 6" of SIPA, which provides for reference to provisions of the Bankruptcy Act (Comp. ¶ 2).[7]

In seeking in the District Court to support his contention of Bankruptcy Act jurisdiction over his common law claims, the Trustee also asserted that such jurisdiction exists in this plenary action because of Touche Ross' purported "consent" to the bankruptcy court's summary jurisdiction by filing claims in the Weis liquidation proceeding for services rendered by Touche Ross to Weis in late 1972 and 1973, well after the completion of the mid-1972 audit work on the 1972 Weis financial reports.[8]

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[7] SIPC also alleged (Comp. ¶ 3), to support subject matter jurisdiction over its common law claims, the now obviously inapplicable "principles of pendent jurisdiction", as well as a claim of diversity jurisdiction that it has now abandoned (see p. 4 n.3, *supra*).

[8] Touche Ross filed two claims in the Weis liquidation proceeding. The first claim sought an aggregate amount of $75,443 for "services rendered covering the regular New York Stock Exchange, Inc. audit as of April 27, 1973 for the purpose of examining the Answers to Financial Questionnaire and Statement of Financial Condition as of that date", for "[s]ervices rendered by our London office covering the examination of the accounts and records, systems review and accounting systems of Weis, Voisin & Co., Inc.—London Branch and Weis, Voisin & Co., International Limited, as of November 24, 1972", for "[s]ervices rendered by our Paris office covering the examination of financial statements of Weis, Voisin S.A.R.L.—Paris as of November 24, 1972, value added tax problem and meeting to discuss present and future operations", and for

However, the complaint significantly does not assert any claim relating to (or even mention) the later services, and does not allege "consent" or Section 23 of the Bankruptcy Act (which authorizes certain consent jurisdiction) as a jurisdictional basis.

D. The District Court's Dismissal Of This Action, And Its Rejection Of The Trustee's Contention Of Bankruptcy Act Jurisdiction

The District Court granted Touche Ross' motion to dismiss this action (391a-412a; 428 F.Supp. 483), and in so doing expressly rejected the Trustee's contention that it had subject matter jurisdiction over his common law claims.[9] Judge Wyatt first dismissed the Trustee's federal Section 17 claim for failure to state a claim upon which relief can be granted. and held that by reason of such dismissal pendent jurisdiction of the Trustee's common law claims was lacking. Judge Wyatt then held that the Bankruptcy Act did not provide subject matter jurisdiction for the Trustee's common law claims.

"[s]ervices rendered by our Paris office covering the preparation of the French corporate income tax return for Weis, Voisin S.A.R.L.—Paris for the year ended December 31, 1972 filed April 30, 1973" (293a-294a). The second claim sought an aggregate amount of $11,664 for "services rendered for benefit of estate", *viz.*, "[m]eetings and conferences with personnel of the New York Stock Exchange, Inc. and the Securities and Exchange Commission", "[s]ubstantiation and documentation of alleged fraudulent bookkeeping practices and entries", and "[c]onfirmation of bank loans and related collateral as of April 13, 1973 applicable to the alleged fraudulent bookkeeping entries" (293a-296a).

[9] Touche Ross' motion sought, *inter alia*, (i) dismissal of the Trustee's federal Section 17 claim for failure to state a claim upon which relief can be granted, (ii) dismissal of the Trustee's common law claims for lack of subject matter jurisdiction, (iii) dismissal of certain of the Trustee's common law claims for failure to state a claim upon which relief can be granted, and (iv) alternatively, a stay of this action pending determination of the State Court Action. It was unnecessary for the District Court to reach, and it did not consider, issues (iii) and (iv).

With respect to the Trustee's contention of Bankruptcy Act jurisdiction, Judge Wyatt held that "[t]he situation at bar . . . is controlled by [Section 23 of the Bankruptcy Act] 11 U.S.C. § 46 which provides that a trustee in bankruptcy may sue only in the courts where the bankrupt might have sued", and that subject matter jurisdiction of the Trustee's common law claims is lacking because "[d]iversity jurisdiction would not exist of an action by Weis against Touche [Ross]" (408a-410a; 428 F.Supp. at 492).[10] Judge Wyatt concluded that Section 23 is applicable and controlling because it is incorporated into SIPA by Section 6(c)(1) thereof.

Judge Wyatt considered and rejected the Trustee's argument that Sections 2a(7), 102 and 115 of the Bankruptcy Act, as purportedly made applicable by Sections 5(b)(2) (another provision not set forth in the Trustee's jurisdictional allegations) and 6(b)(1) of SIPA, confer upon the District Court the broad plenary jurisdiction of a Chapter X reorganization court and a federal equity receivership court—a jurisdiction which was claimed by the Trustee to extend to *any* action commenced by him.

Judge Wyatt also considered and rejected the Trustee's argument, made for the first time after Touche Ross had demonstrated on its motion to dismiss that Section 23 did not permit the exercise of Bankruptcy Act jurisdiction, that Touche Ross had "consented" to such jurisdiction within the meaning of Section 23 by filing its two proofs of claim in the Weis liquidation proceeding. Judge Wyatt found that the Trustee's common law claims here for negligence, malpractice, breach of warranty, and

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[10] The Trustee has never challenged the showing to the District Court, or the District Court's finding, that both Weis and Touche Ross are citizens of New York for purposes of determining whether diversity jurisdiction exists.

breach of contract—claims based upon Touche Ross' mid-1972 audit of the 1972 Weis financial reports—were "unrelated" to the claims filed in the liquidation by Touche Ross for other services rendered to Weis in late 1972 and 1973, stating that "[t]he claim by the Trustee against Touche [Ross] does not arise out of any work done for Weis by Touche [Ross] and for which Touche [Ross] filed a claim in the Weis liquidation" and therefore "the consent of Touche [Ross] cannot be found" (409a-410a; 428 F.Supp. at 492).[11]

E. Other Pertinent Matters

1. THE COMPLAINT IN THE STATE COURT ACTION.—As already noted, the complaint in the earlier-commenced State Court Action involves exactly the same parties, asserts identical factual allegations and (except for the now-untenable federal claims based on Section 17) identical claims, and seeks identical relief as does the complaint here. As this Court's earlier decision herein correctly observed,

> "The common allegations of the plaintiffs in the state court complaint were the same as those in the instant case, except that three paragraphs dealing with claims under section 17 of the '34 Act were omitted. Five of the Trustee's six present 'causes of action' appear in

[11] Apparently because the Trustee characterized one of the Touche Ross claims as a "priority" or administrative claim, Judge Wyatt also found that such claim and the Trustee's common law claims against Touche Ross based upon services performed by Touche Ross almost a year before the Weis collapse were not "mutual" (410a; 428 F.Supp. at 492). As noted (pp. 10-11 n. 8, *supra*), one of Touche Ross' proofs of claim referred in part to services performed in 1973 in connection with "[s]ubstantiation and documentation of alleged fraudulent bookkeeping practices and entries". Nothing in the record supports the Trustee's bald assertion that the practices and entries referred to in that claim are the same as the alleged fraudulent practices and entries which Touche Ross did not detect in mid-1972 (Tr. Br. 6), and Judge Wyatt properly rejected that assertion.

identical form in the state action, as do four of SIPC's eight present claims. The additional claims in this action are the federal securities law claims." 592 F.2d at 620. *See also Touche Ross & Co.* v. *Redington, supra,* 99 S.Ct. at 2484 n.7.

2. THE STATUS OF THE STATE COURT ACTION.— The State Court Action is in the discovery stage. Touche Ross has obtained answers to interrogatories from plaintiffs, and its attorneys and plaintiffs' attorneys have engaged in extensive negotiations, regarding further interrogatory answers to be served by plaintiffs, pursuant to the direction of the Justice of the State Court who presided at the hearing of several discovery motions.

3. THE STATUS OF THE TOUCHE ROSS CLAIMS IN THE WEIS LIQUIDATION.—By stipulation and order dated March 5, 1979, the Touche Ross claims in the Weis liquidation proceeding were dismissed voluntarily with prejudice, prior to any party having obtained any discovery with respect thereto and prior to any hearing on the merits.

ARGUMENT

I

The District Court Correctly Held That Section 23 Of The Bankruptcy Act Is Applicable To Preclude The Exercise Of Bankruptcy Act Jurisdiction, And That The Other Statutory Provisions Relied Upon By The Trustee Do Not Require A Contrary Result

Judge Wyatt held (408a-409a; 428 F.Supp. at 492) that this action "is controlled by [Section 23 of the Bankruptcy Act] 11 U.S.C. § 46 which [is incorprated into SIPA by Section 6(c)(1) thereof and which] provides

that a trustee in bankruptcy may sue only in the courts where the bankrupt might have sued", and that subject matter jurisdiction of the Trustee's common law claims is lacking because "[d]iversity jurisdiction would not exist of an action by Weis against Touche [Ross]".[12]

The Trustee argues that Judge Wyatt was incorrect and that under Section 2a(7) of the Bankruptcy Act—as purportedly made applicable to SIPA liquidations by Section 5(b)(2) of SIPA—the District Court has "the 'powers' of a Chapter X court" and therefore had "*plenary* jurisdiction over any action commenced by the Trustee" (Tr. Br. 5, 9-14). The Trustee also argues that under Section 115 of the Bankruptcy Act the District Court has "the 'home court' jurisdiction of a federal equity receivership court over a plenary action brought by a trustee in the court of his appointment" (Tr. Br. 14 and n.8).[13] As shown hereinafter, Judge Wyatt correctly concluded that Section 23 is applicable and controlling here, and that the Trustee's jurisdictional arguments "cannot be accepted" (409a; 428 F.Supp. at 492).

A. Section 23 Is Incorporated Into SIPA by Section 6(c)(1) Thereof And Applies Here To Preclude Bankruptcy Act Jurisdiction

1. SECTION 23 OF THE BANKRUPTCY ACT.—Section 23 of the Bankruptcy Act, 11 U.S.C. § 46, limits a district court's subject matter jurisdiction over an action brought by a trustee against another party (an "adverse claim-

[12] Judge Wyatt noted that "[i]t seems undisputed that the principal place of business of Weis (28 U.S.C. ¶ 1332(c)) was in New York and that members of the Touche [Ross] firm are citizens of New York" (410a; 428 F.Supp. at 492; *see also* 168a[¶ 5], 289a-290a). The Trustee does not, as he cannot, challenge that finding.

[13] Although the complaint alleges Sections 2a(7) and 115 of the Bankruptcy Act as bases for jurisdiction, it does not allege Section 5(b)(2) of SIPA (Comp. ¶ 2).

ant"), by providing that such jurisdiction exists only to the extent that, had the bankruptcy proceeding not been instituted, there would have been jurisdiction if the action were between the bankrupt and the other party.[14] From its first interpretation by the Supreme Court, only two years after its enactment, Section 23 was held to be a strict limitation on the plenary jurisdiction of the district courts, and to reflect a Congressional intention to direct plenary actions by trustees to the State courts. *See, e.g., Bardes* v. *Hawarden Bank,* 178 U.S. 524, 538 (1900); *Kelley* v. *Gill,* 245 U.S. 116 (1917); *Schumacher* v. *Beeler,* 293 U.S. 367, 374 (1934); *Williams* v. *Austrian,* 331 U.S. 642, 649 (1947). As the Supreme Court explained, for example, in *Schumacher* v. *Beeler,*

> "In enacting §23, it was clearly the intent of the Congress that the federal courts should not have the unrestricted jurisdiction of suits between trustees in bankruptcy and adverse claimants which these courts had exercised under the broad provisions of §2 of the Act of 1867 [an earlier bankruptcy act]. The purpose was to leave such controversies to be heard and determined for the most part in the state courts 'to the greater economy and convenience of litigants and witnesses.'" 293 U.S. at 374.

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[14] Section 23 of the Bankruptcy Act provides as follows:

"§23. Jurisdiction of United States and State Courts. a. The United States district courts shall have jurisdiction of all controversies at law and in equity, as distinguished from proceedings under this Act, between receivers and trustees as such and adverse claimants, concerning the property acquired or claimed by the receivers or trustees, in the same manner and to the same extent as though such proceedings had not been instituted and such controversies had been between the bankrupts and such adverse claimants.

"b. Suits by the receiver and the trustee shall be brought or prosecuted only in the courts where the bankrupt might have brought or prosecuted them if proceedings under this Act had not been instituted, unless by consent of the defendant." 11 U.S.C. §46.

2. SECTION 6(c)(1) OF SIPA, AND ITS INCORPORATION OF SECTION 23 BY REFERENCE TO SECTION 102 OF THE BANKRUPTCY ACT.—Section 6(c) of SIPA, which is entitled "Application of Bankruptcy Act", provides for the incorporation of Section 23 of the Bankruptcy Act into SIPA, by reference to Section 102 of the Bankruptcy Act, as follows:

> "(1) General provisions applicable. Except as inconsistent with the provisions of [SIPA] and except that in no event shall a plan of reorganization be formulated, a liquidation proceeding shall be conducted in accordance with, and as though it were being conducted under, the provisions of chapter X and *such of the provisions* . . . of chapters I to VII, inclusive, of the Bankruptcy Act *as* [*Section 102 of the Bankruptcy Act*] *would make applicable if an order of the court had been entered directing that bankruptcy be proceeded with* pursuant to the provisions of such chapters I to VII, inclusive" (emphasis added). 15 U.S.C. §78fff(c)(1).

Section 102 of the Bankruptcy Act (which is part of Chapter X, dealing with corporate reorganizations) expressly provides that Section 23 will apply when an order of the type referred to in Section 6(c)(1) of SIPA (*i.e.*, an order "directing that bankruptcy be proceeded with") is entered, as follows:

> "The provisions of chapters 1 to 7, inclusive, of [the Bankruptcy Act] shall, insofar as they are not inconsistent or in conflict with the provisions of this chapter, apply in proceedings under this chapter; *Provided, however,* That [*section 23* and portions of three other sections] *shall not apply in such proceedings unless an order shall be entered directing that bankruptcy be*

proceeded with pursuant to the provisions of Chapters 1 to 7, inclusive" (emphasis added). 11 U.S.C. §502.

Thus, the combination of Section 6(c)(1) of SIPA and Section 102 of the Bankruptcy Act operates to make Section 23 of the Bankruptcy Act applicable in every SIPA liquidation proceeding. Section 102 provides that Section 23 is to apply when "an order shall be entered directing that bankruptcy be proceeded with", and Section 6(c)(1) provides that those provisions of the Bankruptcy Act are applicable to a SIPA liquidation that Section 102 "would make applicable if an order . . . had been entered directing that bankruptcy be proceeded with". *See Securities & Exchange Commission* v. *Morgan Kennedy & Co., Inc.*, CCH Fed.Sec.L.Rep. ¶ 94,568, at 95,966 (S.D.N.Y. 1974); 6 COLLIER ON BANKRUPTCY ¶1.06, at 209 (14th ed. 1978). This means, of course, that any action commenced by a SIPA trustee is subject to Section 23 and its express restrictions on bankruptcy jurisdiction and must therefore have some independent basis for federal jurisdiction—*e.g.*, diversity of citizenship between the defunct broker-dealer and the defendant.

The Trustee errs in contending that the reference in Section 6(c)(1) of SIPA to Section 23 is "indirect" (*i.e.*, by means of a reference to Section 102, rather than by means of a direct reference to Section 23), "oblique", and "obscure", and therefore was unconscious or unintentional (Tr. Br. 13). The specific reference in Section 6(c)(1) to Section 102, and to those "provisions" which Section 102 would make applicable under an order to proceed with bankruptcy, evidences a specific Congressional intent, *viz.*, that no matter what else might be incorporated, the "provisions" (which are four specified sections, including Section 23) expressly referred to in Section 102 are to apply in a SIPA liquidation. This was clearly recognized, for example, in *Exchange Nat'l Bank* v. *Wyatt*, 517 F.2d

453, 458 (2d Cir. 1975), where this Court, in construing the "provisions" incorporated into SIPA by Section 6(c)(1)'s reference to Section 102, noted the "specific direction [of Section 102] that the few sections of chapters I to VII expressly made inapplicable to chapter X proceedings prior to such an order shall become applicable when such an order has been made." Of course, one of the "few sections" which this Court recognized as thus made fully applicable under SIPA is Section 23.[15]

3. THE UNAVAILABILITY IN A SIPA LIQUIDATION OF THE BROAD PLENARY JURISDICTION EXERCISED UNDER SECTION 2a(7) OF THE BANKRUPTCY ACT IN CHAPTER X REORGANIZATIONS.—The Trustee cannot avoid the jurisdictional limitations imposed by Section 23 in SIPA liquidations by asserting that under Section 2a(7) of the Bankruptcy Act "a Chapter X court would have plenary jurisdiction over any action commenced by the Trustee" (Tr. Br. 5, 11). Examination of Section 2a(7) and its intended function in a Chapter X reorganization proceeding merely serves to emphasize the function of Section 23 and its strict limitation on the scope of the district court's jurisdiction in a SIPA liquidation.

Section 2a(7) has been held to be the basic jurisdictional provision of the Bankruptcy Act, conferring jurisdiction with respect to both summary proceedings and plenary actions.[16] *Williams* v. *Austrian, supra.* However,

[15] The Trustee suggests that the incorporation of Section 23 by Section 6(c)(1) of SIPA relates only to "the bankruptcy judge's exercise of *summary* jurisdiction over such matters as administrative orders, resolution of claims and distribution of property" (Tr. Br. 12). This suggestion is based upon an erroneous misconception of the purpose and effect of Section 23. *See* 2 COLLIER ON BANKRUPTCY §23.03 (14th ed. 1976) ("the power of a bankruptcy court to act summarily . . . is not in any way restricted by the terms of §23").

[16] Section 2a(7) provides as follows:

"a. The courts of the United States hereinbefore defined as courts of bankruptcy are hereby created courts of bankruptcy and are hereby

Section 2a(7) contains the important phrase "except as herein otherwise provided", a phrase which the Supreme Court has consistently held to be a reference to Section 23, which section therefore necessarily limits the jurisdiction conferred by Section 2a(7). *Williams* v. *Austrian, supra,* 331 U.S. at 649; *First National Bank* v. *Title & Trust Co.,* 198 U.S. 280, 298 (1905); *Bryan* v. *Bernheimer,* 181 U.S. 188, 194 (1901); *Bardes* v. *Hawarden Bank, supra,* 178 U.S. at 535-536.

By virtue of Section 102, Section 23 is inapplicable in Chapter X reorganization proceedings, but only as long as the reorganization itself is going forward (that is, in the words of Section 102, until "an order shall be entered directing that bankruptcy be proceeded with"). Thus, where no such order has been entered, Section 2a(7) provides Chapter X reorganization courts with jurisdiction "to hear plenary suits brought by a reorganization trustee, even though diversity or other usual ground for federal jurisdiction is lacking"; this "extend[s] the jurisdiction of the reorganization courts beyond that exercised by ordinary bankruptcy courts". *Williams* v. *Austrian, supra,* 331 U.S. at 657-658, 661. *Accord, Rochelle* v. *Marine Midland Grace Trust Co.,* 535 F.2d 523 (9th Cir. 1976).

The expansion of jurisdiction for Chapter X courts resulting from the enactment of Section 102 and its suspension of Section 23 in Chapter X reorganizations as long as reorganization is proceeding—an expansion which

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invested . . . with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this Act . . . to—

"(7) Cause the estates of bankrupts to be collected, reduced to money, and distributed, and determine controversies in relation thereto, *except as herein otherwise provided*" (emphasis added).

effected a substantial revision in prior law, *e.g., Williams* v. *Austrian, supra,* 331 U.S. at 661; 6 COLLIER ON BANKRUPTCY ¶1.06[1], at 210 (14th ed. 1978)—had as its purpose the furtherance of the "goal . . . to preserve the going-concern values of the debtor through an effective plan of reorganization". 6 COLLIER ON BANKRUPTCY ¶3.18, at 547 (14th ed. 1978). As Congress recognized, the complex task of reorganizing a corporate debtor under Chapter X, and of seeking thereby "to preserve the going-concern values of the debtor", required an expanded federal jurisdiction, and it enacted Section 102 "to center jurisdiction in the federal courts to the exclusion of state tribunals" so long as the reorganization was going forward.[17] As Congress also recognized, however, such expanded federal jurisdiction would no longer be necessary or appropriate once it became apparent that the reorganization effort would be unsuccessful, and that bankruptcy and consequent liquidation of the debtor would have to proceed. Hence it expressly provided in Section 102 for a return to the normal jurisdictional pattern of Section 23,

[17] "The reason for a more extensive plenary jurisdiction in corporate reorganization [proceedings] is grounded in the very nature of the [proceedings] themselves. In ordinary bankruptcy, the requirements of liquidation were not thought sufficient to center jurisdiction in the federal courts to the exclusion of state tribunals. But in corporate reorganization, the [proceeding] normally affects all creditors and stockholders, all secured and unsecured claims, deals with all the debtor's property, and proceedings in other courts are largely overridden. The goal of the [proceeding] is to preserve the going-concern values of the debtor through an effective plan of reorganization. To accomplish this, expedition and centralization are essential factors. The public interest in securing speedy relief for financially embarrassed corporations is more important than considerations which would require the bringing of all plenary suits in state courts. To that end the reorganization court's concurrent jurisdiction to adjudicate plenary suits has been properly widened by the inapplicability of §23 *until and unless bankruptcy is proceeded with*" (emphasis added). 6 COLLIER ON BANKRUPTCY ¶ 3.18, at 547-548 (14th ed. 1978).

and the traditional Congressional preference reflected therein for State court adjudication of State law claims, as soon as "an order shall be entered [in the reorganization proceeding] that bankruptcy be proceeded with".

In drafting SIPA, and despite various references therein to Chapter X, Congress clearly intended that SIPA proceedings result in liquidation, rather than reorganization, of the broker-dealer involved, and recognized that there was thus no purpose in maintaining in SIPA liquidations the suspension of Section 23's jurisdictional limitations which Section 102 imposes in reorganization proceedings—just as there was no purpose in maintaining the suspension even in Chapter X reorganizations after it was directed that bankruptcy, and consequent liquidation, of the debtor should proceed. Thus, Congress expressly provided in Section 6(a)(4) of SIPA that the overriding purpose of a SIPA proceeding is "to liquidate the business of the debtor", and reiterated in Section 6(c)(1) itself that, despite the reference therein to Chapter X, "in no event shall a plan of reorganization be formulated". Congress then eliminated Section 102's suspension of the jurisdictional limitations of Section 23, by expressly providing in Section 6(c)(1) that SIPA proceedings were to be subject to such "provisions . . . of chapters I to VII . . . as [Section 102] would make applicable if an order of the court had been entered directing that bankruptcy be proceeded with". *See, e.g., Securities & Exchange Commission* v. *Morgan Kennedy & Co., supra,* CCH Fed.Sec.L.Rep. ¶94,568, at 95,968-95,969 ("Congress . . . intended SIPA to be a statute whose dominant impulse is that of a liqudation and not a reorganization" and "Congress proposed that a SIPA proceeding be governed by the rules applicable to a liquidating reorganization under Chapter X", including the limitations on jurisdiction in Section 23 as made applicable by Section 102); 3 COLLIER

ON BANKRUPTCY ¶60.86, at 1252 (14th ed. 1977) ("the intention of [§6(c)] was to incorporate all the provisions of Chapters I to VII which are not inconsistent with SIPA, including those enumerated sections in Section 102 which have no application to a Chapter X case unless bankruptcy ensues"); *Exchange Nat'l Bank* v. *Wyatt, supra,* 517 F.2d at 458-459 (reference provision of straight bankruptcy (§22), rather than reference provision of Chapter X (§117), is applicable in SIPA liquidation by virtue of Section 102, which is to be read as if liquidation has been ordered).

The Trustee's argument ignores the fact that the plenary jurisdiction in Chapter X reorganizations recognized in *Williams* v. *Austrian, supra,* although conferred by Section 2a(7) of the Bankruptcy Act, springs entirely from the effect of Section 102 of Chapter X, that Section 102 provides for different results (including a different result as to whether Section 23 is applicable) depending upon whether a reorganization is in progress or whether a liquidation has been ordered, and that it is necessary to know which of these two alternatives is applicable before Section 102 may be given effect. Of course, Section 6(c)(1) of SIPA answers precisely that question, since it states that Section 102 must be read as "if an order of the court had been entered directing that bankruptcy be proceeded with", with the result that Section 23 is always applicable in a SIPA liquidation. The Trustee's argument requires Section 102 to be read in precisely the opposite way, as if an ongoing reorganization was being conducted. That not only conflicts with the clear language of Section 6(c)(1) of SIPA, but also entirely disregards the fact that a SIPA proceeding is, as shown hereinabove, a liquidation and not a reorganization.

4. THE EFFECT HERE OF SECTION 23.—Under Section 23, as Judge Wyatt correctly held, the District Court would have subject matter jurisdiction of the Trustee's common law "causes of action" only to the extent jurisdiction would have existed in an action between Weis itself and Touche Ross. However, as Judge Wyatt also correctly held, no diversity jurisdiction would have existed for such an action since both Weis and Touche Ross were citizens of New York (see p. 12 n.10, *supra*), and therefore under Section 23 the District Court has no jurisdiction of the Trustee's common law "causes of action".

B. Section 5(b)(2) Of SIPA Does Not Provide Jurisdiction For The Trustee's Common Law "Causes Of Action"

The Trustee argues that Section 5(b)(2) of SIPA, 15 U.S.C. § 78eee(b)(2), is the "key jurisdictional provision" of SIPA, that it implicitly incorporates into SIPA the plenary jurisdiction conferred by Section 2a(7) of the Bankruptcy Act unfettered by the limitations in Section 23 of the Bankruptcy Act, and that the explicit incorporation into SIPA of Section 23 of the Bankruptcy Act by Section 6(c)(1) of SIPA and its reference to Section 102 of the Bankruptcy Act is nullified by a purported "inconsistency" with the Trustee's interpretation of Section 5(b)(2) (Tr. Br. 9-14). However, the issue here is not whether the jurisdictional provisions of Section 2a(7) of the Bankruptcy Act are incorporated into SIPA, but whether or not the limitations thereon established by Section 23 of the Bankruptcy Act are suspended in a SIPA liquidation. As already shown (see pp. 15-23, *supra*), the express language of SIPA and the nature of a SIPA liquidation demonstrate that Section 23 is *not* suspended. The Trustee's argument to the contrary is based upon a

misinterpretation of Section 5(b)(2) of SIPA. That argument fails because Section 5(b)(2) does not deal with the *plenary* jurisdiction of the District Court, and because the phrase "powers . . . of a court in a proceeding under Chapter X of the Bankruptcy Act" appearing in Section 5(b)(2) is not a reference to the plenary jurisdiction that is exercised by a Chapter X reorganization court in an ongoing reorganization where Section 23 of the Bankruptcy Act has been suspended by Section 102 of Chapter X.

The Trustee takes out of context, and misleadingly quotes, the words of Section 5(b)(2) that the court in a SIPA proceeding shall have the " 'powers *** of a court of bankruptcy *and of a court in a proceeding under Chapter X of the Bankruptcy Act*' " (emphasis added by Trustee) (Tr. Br. 10). The full sentence of Section 5(b)(2) from which the Trustee artfully selects, without regard to context, reads as follows (with the critical portion omitted by the Trustee set forth in italics):

> "Upon the filing of an application pursuant to subsection (a)(2) of this section, the court to which application is made shall have *exclusive jurisdiction of the debtor involved and its property wherever located* with the powers, to the extent consistent with the purposes of this act, of a court of bankruptcy and of a court in a proceeding under Chapter X of the Bankruptcy Act" (emphasis added).

The italicized words make clear that this sentence of Section 5(b)(2) applies only to the *summary* jurisdiction of the bankruptcy judge over the debtor and his assets, and is not a section providing plenary jurisdiction over actions against third persons. Although the legislative

history does not discuss the sentence,[18] the sentence's language is familiar from the Bankruptcy Act, which has used language virtually identical to Section 5(b)(2)'s language of "exclusive jurisdiction of the debtor involved and its property wherever located" to confer jurisdiction in at least eight different places.[19] It is uniformly held that such language simply provides for the summary jurisdiction of a bankruptcy judge over the assets in the possession of the debtor, essentially a form of *in rem* jurisdiction.[20] Of course, it is well-settled that claims against third

[18] The sentence did not appear in the original bill in the House of Representatives, H.R. 13308, 91st Cong., 2d Sess. The italicized words first appear, in identical form, in two bills presented to the House on successive days, one drafted by the SEC, H.R. 18081, 91st Cong., 2d Sess. §35(j)(3), and the other by a group representing the securities industry, H.R. 18109, 91st Cong., 2d Sess., §36(a)(5). The final form of the quoted sentence emerged from the joint efforts of those same drafters. H.R. 18458, 91st Cong., 2d Sess., §35(m)(4). In addressing the liquidation provision of H.R. 18109, 91st Cong., 2d Sess., Ralph DeNunzio, Chairman of the industry group, declined to comment at length, stating only that the subject was "highly technical". Hearings before a Subcomm. of the House Comm. on Int. & For. Comm., 91st Cong., 2d Sess., Serial No. 91-67 at 167 (1970). From this, and from the simultaneous occurrence in two bills of the identical language, it can be inferred that the choice of language was intentional, not fortuitous, and had reference to "technical"—*i.e.*, established—uses of the terminology. Hence the meaning given to the terms in the Bankruptcy Act, the source of the terminology, is particularly pertinent.

[19] Such language is used in Section 75(n), 11 U.S.C. §203(n) (farmer's relief); Section 77, 11 U.S.C. §205 (railroad reorganizations); Section 77B(a), Act of June 7, 1934, §77B(a), 48 Stat. 911, 912 (predecessor of Chapter X; now repealed); Section 82(a) of Chapter IX, 11 U.S.C. §402(a); Section 111 of Chapter X, 11 U.S.C. §511; Section 311 of Chapter XI, 11 U.S.C. §711; Section 411 of Chapter XII, 11 U.S.C. §811; and Section 611 of Chapter XIII, 11 U.S.C. §1011.

[20] *E.g.*, "[t]he grant of exclusive jurisdiction [in section 77B(a)] over the debtor and its property was not a departure from established bankruptcy practice. The Bankruptcy Act . . . from the time of its enactment had conferred upon courts of bankruptcy exclusive jurisdiction over bankrupts and their property . . . . Congress did not intend to ignore the distinction theretofore recognized in the Bankruptcy Act between jurisdiction over persons and jurisdiction of property—between proceedings in personam and in rem—and that subdivi-

persons may not be adjudicated under the summary jurisdiction of the bankruptcy courts, but must be the subject of a plenary suit, *e.g., Cline* v. *Kaplan,* 323 U.S. 97 (1944); *Taubel-Scott-Kitzmiller* v. *Fox,* 264 U.S. 426 (1924); *Kelley* v. *Gill,* 245 U.S. 116 (1917); *Harrison* v. *Chamberlin,* 271 U.S. 191, 193-195 (1926),[21] and the cases recognize that the summary jurisdiction conferred by the "exclusive jurisdiction" language of the Bankruptcy Act sections referred to above does not extend to a power to adjudicate claims against third persons.[22]

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sion a of section 77B did not affect the existing jurisdiction of the bankruptcy courts over the former or conflict with the restrictions which section 23 placed upon that jurisdiction." *In re Standard Gas & Elec. Co.,* 119 F.2d 658, 661, 662 (3d Cir. 1941). *See also, e.g., Continental Illinois Nat'l Bank & Trust* v. *Chicago, R.I. & Pac. Ry. Co.,* 294 U.S. 648, 681-684 (1935) (Section 77B); *In re Prudence Bonds Corp.,* 75 F.2d 262 (2d Cir. 1935) (Section 77B(a)); *Thompson* v. *Terminal Shares,* 104 F.2d 1, 9 (8th Cir. 1939) (Section 77B(a)); *Mar-Tex Realization Corp.* v. *Wolfson,* 145 F.2d 360, 362-363 (2d Cir. 1944) (Section 111); *Duda* v. *Sterling Mfg. Co.,* 178 F.2d 428 (8th Cir. 1949) (Section 111); *Slenderella Systems of Berkeley, Inc.* v. *Pacific Tel. & Tel.,* 286 F.2d 488 (2d Cir. 1961) (Section 311); *In re Oliver,* 127 F.Supp. 842, 845-847 (D. Kan. 1955) (Section 611); *Tamasha Town & Country Club* v. *McAlester Constr. Fin. Corp.,* 252 F.Supp. 80, 85 and n. 1 (S.D. Cal. 1966) (Section 311).

[21] As this Court has stated, "an action to enforce a debt from the alleged debtor of the bankrupt, where the debtor denies the existence of the debt, is not within the summary jurisdiction", since in such cases the trustee "cannot claim possession, because the existence of the chose in action is the issue in dispute." *In re Eakin,* 154 F.2d 717, 719 (2d Cir. 1946). *See also In re Roman,* 23 F.2d 556, 558 (2d Cir. 1928) ("So far as possession can be imputed to such property at all, it is confined to the rights of the bankrupt to enforce the promise . . . . in a court having competent jurisdiction") (L. Hand, J.).

[22] *See, e.g., Duda* v. *Sterling Mfg. Co., supra* (jurisdiction under Section 111 does not extend to contract and other claims existing at time of filing of Chapter X petition); *Slenderella Systems of Berkeley, Inc.* v. *Pacific Tel. & Tel. Co., supra* (disputed contract claim not subject to Section 311 jurisdiction); *Tamasha Town & Country Club* v. *McAlester Constr. Fin. Corp., supra* (damage action to enforce statutory penalty not within Section 311 jurisdiction); *In re Prudence Bonds Corp., supra* (pledgee in possession not required to litigate the validity of his claim in summary proceeding under Section 77B(a)); *In re Standard Gas & Elec. Co., supra* (trustee in Section 77B proceeding has no jurisdiction under Section 77B(a) to proceed summarily against parties alleged to have violated fiduciary duties to the debtor corporation).

Since Section 5(b)(2) uses precisely the same language as is found in the Bankruptcy Act, and since that language has been expressly held not to confer plenary jurisdiction over actions brought by a trustee against third persons, Section 5(b)(2) cannot properly be read to provide such jurisdiction here over the Trustee's common law "causes of action". This was recognized in *Securities & Exchange Commission* v. *Morgan Kennedy & Co., supra,* CCH Fed.Sec.L.Rep. ¶94,568, at 95,971, where Bankruptcy Judge Babitt held that Section 5(b)(2) did not provide any jurisdiction which would override the jurisdictional limitations imposed by Section 23 of the Bankruptcy Act, because:

> "Congress drafted SIPA to be read, where appropriate, in light of the rules pertaining to Chapter X, including broad powers to administer the debtor's assets. But this is not inconsistent with the application of liquidation rules, i.e., Section 23, where appropriate, to litigation arising during the liquidation. *Power over assets is one thing; power over disputes is another*" (emphasis added).

Moreover, since Section 5(b)(2) speaks of both the "exclusive jurisdiction" and the "powers" of the court, its use of the word "powers" (upon which the Trustee relies) obviously must be a reference to something else besides "jurisdiction".[23] The context demonstrates that it means "powers" with respect to the property over which the court has jurisdiction—*i.e.,* the power to use all the remedial devices a bankruptcy court or a Chapter X court might use to protect the debtor's property.

Finally, it is to be noted that Section 5(b)(2) speaks of "exclusive jurisdiction", so that if the Trustee were

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[23] See also discussion of the meaning of the word "power" in Section 115 of the Bankruptcy Act at p. 30, *infra.*

correct in arguing that Section 5(b)(2) provides plenary jurisdiction here, it would mean that he could bring no action in any court other than the court in which the SIPA liquidation was proceeding and that his own State Court Action was improper. The absurdity of that result demonstrates the error of the Trustee's premise that Section 5(b)(2) deals with plenary jurisdiction. The "exclusive jurisdiction" language of Section 5(b)(2) and its statutory predecessors has not been read to contract (because it does not concern) the powers of a trustee to pursue those indebted to the debtor's estate in other courts. *See Williams* v. *Austrian, supra* (Chapter X reorganization trustees may bring plenary suits in other districts); 6 COLLIER ON BANKRUPTCY ¶3.18, at 539 (14th ed. 1978); *cf. Bardes* v. *Hawarden Bank, supra,* 178 U.S. at 532-33 (plenary jurisdiction is concurrent with, not exclusive of, jurisdiction of state courts).[24]

C. Section 115 Of The Bankruptcy Act Does Not Provide Jurisdiction For The Trustee's Common Law "Causes of Action"

The Trustee points out that Section 6(c)(1) of SIPA incorporates Section 115 of the Bankruptcy Act (which, like Section 102, is part of Chapter X) and contends that Section 115 confers on the District Court here all the jurisdiction of a federal court supervising an equity receivership (Tr. Br. 14 n. 8). That contention is erroneous.

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[24] The Trustee also errs in asserting that in Section 6(b)(1) of SIPA, 15 U.S.C. §78fff(b)(1), "Congress augmented and reinforced the grant of 'power' to the district courts" (Tr. Br. 11 n. 6). Section 6(b)(1) prescribes only the powers of a SIPA trustee, and has nothing to do with either the "power" or the jurisdiction of a district court.

Section 115 provides in pertinent part that

> "Upon the approval of a petition, the court shall have and may, in addition to the *jurisdiction, powers, and duties* hereinabove and elsewhere in this chapter conferred and imposed upon it, exercise all the *powers*, not inconsistent with the provisions of this chapter, which a court of the United States would have if it had appointed a receiver in equity" (emphasis added). 11 U.S.C. §515.

The Trustee's assertion that Section 115 is a grant of jurisdiction is simply not in accord with its language. Thus, Section 115 confers upon a Chapter X court only the "powers" of an equity receivership court, whereas in the same sentence it also speaks of the "jurisdiction, powers, and duties" otherwise conferred. This clearly shows that Congress understood that the terms "powers" and "jurisdiction," in Section 115, signified separate and distinct concepts and compels the conclusion that Congress intended to confer only "powers" but not "jurisdiction". *See* 6 COLLIER ON BANKRUPTCY ¶3.18, at 546-547 n.34 (14th ed. 1978) ("while §115 confers all the *powers* of an equity receivership court upon the reorganization court, it makes no reference to the jurisdiction of the equity receivership court").

In fact, the legislative history reveals a Congressional understanding that Section 115 does not constitute a jurisdictional grant, and an intention that it should not. Thus, an amendment to Section 115 which would have provided an express grant of equity receivership jurisdiction was introduced in the Senate and was rejected.[25]

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[25] Senator King, a member of the Judiciary Committee which reported on the Chandler Act, S. Rep. No. 1916, 75th Cong. 3d Sess. (1938), proposed an amendment on the Senate floor that, among other things, would have provided that "the jurisdiction, powers and duties of the court . . . shall be the same as in a proceeding in equity in a court of the United States in which a receiver of the debtor had been appointed on the ground of insolvency or inability to meet its debts as they mature." 83 Cong. Rec. 8708 (1938) (§129 of King amendment). The Senate rejected the amendment. *Id.* at 8728.

Congress took the language of Section 115 from the virtually identical language of Section 77B(a) of the Bankruptcy Act, which had been enacted in the Corporate Reorganization Act of 1934.[26] It was uniformly held that Section 77B(a) did not create a grant of jurisdiction to the district courts and that, as this Court early concluded,

> "Congress did not intend the bankruptcy court in proceedings under section 77B to take over all litigation between the debtor and third persons." *In re Prudence Bonds Corp., supra,* 75 F.2d at 263 (L. Hand, J.).

Accord, United States v. *Tacoma Oriental S.S. Co.,* 86 F.2d 363, 368 (9th Cir. 1936); *In re Standard Gas & Elec.Co., supra* (§77B did not give jurisdiction to hear a trustee's plenary suit in federal district court).

Moreover, a consistent series of cases, occurring mostly in the Second Circuit, has interpreted the "powers" language of Section 115 and the predecessor language of Section 77B to mean the non-jurisdictional substantive powers over property exercised by a court of equity.[27] As

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[26] In enacting Chapter X, "[b]y and large . . . the substance of section 77B is preserved" and "[s]ection 115 is derived from section 77B(a), with only minor changes in language." S. Rep. No. 1916, 75th Cong., 3d Sess. at 19, 24 (1938). Hence, decisions interpreting Section 77B(a) are applicable to Section 115.

[27] Such "powers" have been held to include, for example, the power to determine priorities among claimants, *Reading Co.* v. *Brown,* 391 U.S. 471, 489 and n.6 (1968) (Warren, C.J., dissenting); *In re Yale Express Systems, Inc.,* 362 F.2d 111, 117 n.5 (2d Cir. 1966); *In re Chicago Express, Inc.,* 332 F.2d 276, 278 (2d Cir.), *cert. denied,* 379 U.S. 879 (1964); *In re Hallmark Medical Services Inc.,* 475 F.2d 801, 804 n.6 (5th Cir.), *cert. denied,* 414 U.S. 1003 (1973); *United States* v. *Anderson,* 334 F.2d 111, 115 (5th Cir.), *cert. denied,* 379 U.S. 879 (1964); *In re Charles Nelson Co.,* 29 F.Supp. 56, 57 (N.D. Cal. 1939) (§77B(a)); *In re Sixty-Seven Wall St. Rest. Corp.,* 23 F. Supp. 672, 673 (S.D.N.Y. 1938) (§77B(a)); the power to sell perishable property, *In re V. Loewer's Gambrinus Brewery Co.,* 141 F.2d 747 (2d Cir. 1944); the power to settle claims against the debtor's estate, *In re Paramount Publix Corp.,* 7 F.Supp. 988

the Third Circuit phrased it, with regard to Section 77B(a),

> "This reference to the powers which a federal equity court exercises when it appoints a receiver is to the substantive powers which such a court exercises over the property in its custody rather than to its jurisdiction to entertain plenary suits growing out of the receivership." *In re Standard Gas & Elec. Co., supra,* 119 F.2d at 662.

Accord, In re Prudence Co., 82 F.2d 755, 757 (2d Cir.), *cert. denied,* 298 U.S. 685 (1936); *In re Prima Co.,* 98 F.2d 952, 958 (7th Cir.), *cert. denied,* 305 U.S. 658 (1938).[28]

None of the cases cited by the Trustee (Tr. Br. 14 n.8) for the proposition that Section 115 is a grant of plenary jurisdiction so holds. One of these cases, *Williams* v. *Austrian, supra,* 331 U.S. at 659-661, found it unnecessary to reach the issue of whether Secton 115 was jurisdictional because of its holding that, in light of Section 102's suspension of the limitations of Section 23 during reorganization, jurisdiction there existed by virtue of Section 2a(7). In the footnote referred to by the Trustee, the Supreme Court, after pointing out the decisions which

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(S.D.N.Y. 1934) (§77B(a)); the power to allow or disallow interest on claims, *Vanston Committee* v. *Green,* 329 U.S. 156, 165 and n.8 (1946); and the power to consolidate several reorganizations into a single proceeding, 6 COLLIER ON BANKRUPTCY ¶ 3.17, at 534 (14th ed. 1978); *In re Schafer's Bakeries,* 129 F.Supp. 82, 85 (E.D. Mich. 1955).

[28] While the legislative history apparently has no discussion regarding the subject-matter jurisdiction of the federal courts in either the hearings or the debates on the Chandler Act, the importance of equitable remedies was emphasized. *See* Hearings before a Subcommittee of the Senate Comm. on the Judiciary on H.R. 8046, 75th Cong. 2d Sess. (1937-1938). Statement of John Gerdes, presenting amendments suggested by national bankruptcy conference, at 77 (priorities to be those in equity receiverships); Letter of Garrett Brownback at 205-206 (importance of flexible equitable remedies).

hold the "powers" language of Section 77B and Section 115 to be "nonjurisdictional", cited two of the cases here cited by the Trustee as conflicting interpretations. Examination of those two cases (*Warder* v. *Brady* and *In re Cuyahoga Finance Co.*) shows, however, that even they did not hold that Section 115 is a grant of plenary jurisdiction.[29]

[29] The language in *Warder* v. *Brady,* 115 F.2d 89, 94 (4th Cir. 1940), regarding Section 115 is pure *dictum.* A special receiver had been *summarily* ordered to turn over money he held on behalf of bondholders; on appeal the Fourth Circuit mentioned in passing that it felt that Section 115 might confer jurisdiction over a *plenary* suit, but reversed the order on the ground that the bankruptcy judge could not issue it *summarily.* Moreover, the Fourth Circuit discussed at greater length than it did Section 115 the effect of Section 102's suspension of the limitations of Section 23 on the jurisdiction granted by Section 2a(7), and it is unclear which statutory provision was regarded by the Court as essential to its analysis, Section 115 or Section 102. *In re Cuyahoga Finance Co.,* 136 F.2d 18, 20 (6th Cir. 1943), and the Trustee's other case, *In re Federal Facilities Realty Trust,* 220 F.2d 495, 499 (7th Cir. 1955), both dealt with the *summary* jurisdiction of a bankruptcy judge, and *not* with the *plenary* jurisdiction of a district court, and thus are both in accord with the language quoted from *Standard Gas & Elec. Co., supra,* which held that Section 115's predecessor, Section 77B(a), only granted those "substantive powers which such a court exercises over the property in its custody"—*i.e., summary* jurisdiction. *Cuyahoga Finance* was an appeal of a *summary* turnover order granted against a pledgee in possession of the debtor's goods; the Sixth Circuit held that Section 115 supported that exercise of *summary* jurisdiction. *Federal Facilities Realty Trust* held that the bankruptcy judge's jurisdiction over the *res* provided *summary* jurisdiction over the trustee's claim to funds about to be distributed from the estate to employees whom the trustee had hired to perform tasks during the reorganization and for whose wrongful acts the trustee had been surcharged. Neither case dealt with the plenary jurisdiction of a district court to hear cases brought by a trustee. Both cases suffer from further weakness insofar as one might cite them as interpretations of Section115. The Court in *Cuyahoga Finance,* like the *Warder* Court, never made clear whether it regarded jurisdiction to exist by reason of the addition of Section 115 or by reason of Section 102's suspension of the limitations of Section 23, and *Federal Facilities* only mentions Section 115 in passing in a single sentence that appears to have no bearing on the outcome of the case.

Actually, it would have been superfluous for Congress to have vested Chapter X reorganization courts with the jurisdiction of an equity receivership court. As the Trustee points out, an equity receiver is only entitled to bring a plenary action in his "home court" (Tr. Br. 14 n.8). By virtue, however, of the jurisdiction provided by Section 2a(7), and Section 102's suspension of the limitations of Section 23 during a Chapter X reorganization, a Chapter X reorganization trustee can bring plenary actions in any district court where venue is proper and he can obtain personal jurisdiction. *Williams* v. *Austrian, supra,* 331 U.S. at 661; *Rochelle* v. *Marine Midland Grace Trust Co. of New York, supra; Magidson* v. *Duggan,* 180 F.2d 473, 476-477 (8th Cir.), *cert. denied,* 339 U.S. 965 (1950); 6 COLLIER ON BANKRUPTCY ¶3.18, at 539 (14th ed. 1978).[30]

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[30] The legislative history does not support the Trustee's argument that Section 115 was intended to provide plenary jurisdiction in the "home court". The language on which Section 115 is based first appeared in H.R. 5009, 73d Cong., 1st Sess., the immediate predecessor bill to the one enacted as Section 77B. *See* Friendly, *Some Comments on the Corporate Reorganization Act,* 48 Harv. L. Rev. 39, 50-51 & n. 45 (1934). The precise language added to H.R. 5009, which followed a grant of "exclusive jurisdiction of the debtor and its property wherever located," provided that the court "shall and may exercise all of the powers, not inconsistent with this section, which a federal court would have had if it appointed a receiver in equity of the property of the debtor on the ground of insolvency." The sponsor of the bill, Representative McKeown, explained the reason:

> "Now that is a change in the language [from earlier corporate reorganization bills] for this reason: It seems that in the case of *Phipps* v. *Chicago* (284 Fed. Rep.), that decision suggested the advisability of conferring upon the court the power of Federal courts in equity jurisdiction." Statement of Rep. McKeown, Hearings before House Jud. Comm. on H.R. 1670, H.R. 3083, H.R. 4311, H.R. 5267 and H.R. 5009, 73d Cong. 1st Sess. at 188 (1933).

The case which Rep. McKeown cited, *Phipps* v. *Chicago, R.I.&P. Ry. Co.,* 284 Fed. 945 (8th Cir. 1922), had nothing to do with the "home court" jurisdiction of the federal district court in an equity receivership, but concerned only the equitable powers of the bankruptcy court, usually exercised in summary proceedings, to control, protect and transfer the debtor's property. There is not the slightest indication in either the *Phipps* case or Rep. McKeown's comment to suggest that the statutory language now set forth in Section 115 intended to confer anything more than such powers on a reorganization court.

Finally, even if the "powers" language of Section 115 were somehow assumed to be a grant of jurisdiction, Section 23 would limit that jurisdiction just as it limits jurisdiction under Section 2a(7). Like Section 2a(7), the "powers" provided for in Section 115 are those "not inconsistent with the provisions of this chapter". One of the provisions of "this chapter" is Section 102, which explicitly makes Section 23 applicable in the liquidation context present here. It makes more than linguistic sense for Section 115, assuming it grants jurisdiction, to be subordinate to Section 23. As already indicated, when a court order terminates a Chapter X reorganization and initiates liquidation, the trustee has no more need than any other bankruptcy trustee for the broad plenary jurisdiction of the reorganization courts. Whether that plenary jurisdiction were to derive from Section 2a(7) or Section 115 cannot alter its cessation with liquidation. *See* 6 COLLIER ON BANKRUPTCY ¶3.18, at 544-545 (14th ed. 1978). Nor can it be that somehow Section 115, because of some inherent quality that distinguishes it from Section 2a(7), escapes the effect of Section 23. Cases decided under Section 77B make this clear. Acting through Section 77B(o) which, to the extent consistent with Section 77B, made the "jurisdiction . . . [of] the court . . . the same" as in bankruptcy and hence incorporated Section 23, *e.g., In re Standard Gas & Electric Co., supra,* 129 F.2d at 660-663, Section 23 was always held to control jurisdiction under Section 77B, despite the presence there of the predecessor language to Section 115. *Tilton* v. *Model Taxi Corp.,* 112 F.2d 86, 88 (2d Cir. 1940); *In re Prima Co., supra,* 98 F.2d at 958 (the predecessor language to Section 115 did not "amount to a repeal by implication of Section 23").

Thus, Section 115 does not confer the "home court" or any other plenary jurisdiction of an equity receivership court[31]— and even if it did, under SIPA Section 23 would control that jurisdiction—and the cases cited by the Trustee which involve the equity receivership jurisdiction are irrelevant here.

II

The District Court Correctly Held That Touche Ross Did Not "Consent" To Jurisdiction In This Plenary Action By Filing Proofs Of Claim

The District Court correctly held (490a-410a; 428 F.Supp. at 492) that Touche Ross did not, by filing its proofs of claim in the Weis liquidation proceeding, "consent" to jurisdiction with respect to the Trustee's common law claims in this plenary action, for at least two reasons. First, the filing of the proofs of claim calls into play only the *summary* jurisdiction of the bankruptcy court, and is insufficient to confer jurisdiction in this *plenary* action. Second, even if it were assumed that "consent" to jurisdiction in a *plenary* action could be inferred from filing a proof of claim to the same extent that consent to *summary* jurisdiction can be so inferred, there still would be no jurisdiction here because Touche Ross' proofs of claim would not have conferred jurisdiction of the Trustee's common law claims even in a summary proceeding.

[31] It is doubtful that Section 115 or any provision of the Chandler Act was intended to keep alive equity receiverships. As Representative Chandler, the sponsor of the bill, explained to the Senate Committee on the Judiciary, he and the other drafters "endeavored, as far as possible, to get rid of receivership proceedings." Statement of Rep. Chandler, Hearings before a Subcommittee of the Senate Comm. on the Judiciary on H.R. 8046, 75th Cong. 2d Sess. at 4 (1937-1938).

A. The Proofs of Claim Do Not Confer Jurisdiction In This Plenary Action

Section 23 of the Bankruptcy Act, which is applicable in every SIPA liquidation, and which the Trustee concedes to be applicable for purposes of his consent argument (Tr. Br. 15), was enacted to limit the broad grant of jurisdiction conferred on district courts in plenary proceedings by Section 2a of the Bankruptcy Act and its antecedents (see pp. 15-16, *supra*). Section 23b also contains a provision which authorizes the exercise of federal jurisdiction "by consent of the defendant". The provision regarding consent was included as a concession to the defendant who "might not object to—indeed would welcome—federal court jurisdiction." *Tenenbaum* v. *Walter E. Heller & Co.*, 308 F.Supp. 1085, 1087 and n.9 (S.D.N.Y. 1970) (citing remarks of Senator Lindsay at 30 Cong. Rec. 601-602 (1897)).

However, the filing of a proof of claim does not constitute such "consent" to *plenary* jurisdiction under Section 23. As the Tenth Circuit has unequivocally stated,

> "a claimant does not consent to the exercise of the bankruptcy court's plenary jurisdiction by filing his claim in the bankruptcy proceedings." *Katchen* v. *Landy*, 336 F.2d 535, 537 (10th Cir. 1964), *aff'd*, 382 U.S. 323 (1966).

Although in certain circumstances *summary* jurisdiction may be exercised on the basis of consent inferred from the act of filing a proof of claim, *plenary* jurisdiction may not be exercised on such a basis. *Tamasha Town & Country Club* v. *McAlester Const. Fin. Corp., supra*, 252 F.Supp. at 89 ("[T]he policy underlying the doctrine of consent to summary jurisdiction by acts of the claimant, is avoiding multiplicity of actions and permitting the casting of accounts between the parties. Neither of these would be advanced by extending the doctrine of consent by acts of

the claimant to a plenary proceeding"). It is for reasons of judicial economy that courts have treated the act of filing a proof of claim as consent by the creditor to *summary* jurisdiction with respect to certain claims which a trustee wishes to assert as counterclaims in the liquidation proceeding itself (see pp. 40-41, *infra*). There is no justification (and the Trustee cites no authority) for permitting him—in derogation of the very reason for implying such consent in the first place—to utilize the doctrine of consent to *summary* jurisdiction to assert his claims outside of the liquidation proceeding itself and in a separate *plenary* action.

The type of consent which is necessary to support *plenary* jurisdiction under Section 23 is express consent by a defendant to the jurisdiction of the district court over the plenary action or consent by the defendant's pleading to the merits in the plenary action without objection to jurisdiction. 2 COLLIER ON BANKRUPTCY ¶ 23.14, at 602 (14th ed. 1976).[32] But where, as here, a defendant makes

[32] Courts have found consent to *plenary* jurisdiction in a general appearance and a plea on the merits, *Schumacher* v. *Beeler, supra,* 293 U.S. at 369 (declining to permit party, after those steps, to withdraw consent and contest jurisdiction); explicit admissions of jurisdiction and litigation on the merits, *Gins* v. *Mauser Plumbing Supply Co.,* 148 F 2d 974, 977 n.5 (2d Cir. 1945); a specific concession of jurisdiction and litigation on the merits, *Tilton* v. *Model Taxi Corp.,* 112 F.2d 86, 88 (2d Cir. 1940); litigation on the merits and a failure to object to jurisdiction, *Toledo Fence & Post Co.* v. *Lyons,* 290 Fed. 637, 639-640 (6th Cir. 1923); *In re Prima Co.,* 98 F.2d 952, 959 (7th Cir.), *cert. denied,* 305 U.S. 658 (1938); a stipulation that the court had jurisdiction, *Green* v. *Gage,* 186 F.2d 984, 986-987 (5th Cir. 1951); pleading to the merits and taking testimony, *Detroit Trust Co.* v. *Pontiac Savings Bank,* 196 Fed. 29, 31-32 (6th Cir. 1912), *aff'd,* 237 U.S. 186 (1915); answering on the merits or appearing in court to seek affirmative relief, *May* v. *Moss,* 194 F.2d 133, 137 (8th Cir.), *cert. denied,* 343 U.S. 952 (1952); and appearing, pleading to the merits, affirmatively requesting relief and litigating the merits at trial and on appeal, *Wymard* v. *McCloskey & Co.,* 342 F.2d 495, 497-498 (3d Cir.) (en banc), *cert. denied,* 382 U.S. 823 (1965) (3 judges dissented, taking the position that under the circumstances even these facts did not suffice to show consent to jurisdiction).

no answer on the merits and expressly objects to jurisdiction by moving to dismiss the action for lack of subject matter jurisdiction, no consent exists or may be implied under Section 23. *See Halpert* v. *Engine Air Service,* 116 F.Supp. 13, 15 (E.D.N.Y. 1953); *cf. Stiefel* v. *14th Street & Broadway Realty Corp.,* 48 F.2d 1041, 1043 (2d Cir. 1931).

None of the cases cited by the Trustee (Tr. Br. 18-19 n.11) supports his theory that a creditor, who by filing a proof of claim implicitly consents to summary jurisdiction of certain of the trustee's counterclaims, also thereby consents to the court's jurisdiction of an entirely separate *plenary* action commenced by the trustee based on those claims. *Chase Nat'l Bank* v. *Lyford,* 147 F.2d 273 (2d Cir. 1945) held only that by filing a proof of claim, claimant consented to summary jurisdiction of a related counterclaim and could not insist on a plenary action with respect thereto.[33] *Whitney* v. *Wenman,* 198 U.S. 539 (1905), did not involve the issue of consent jurisdiction, but held merely that under Section 2a the trustee could bring a plenary action (even though summary jurisdiction also would have existed) to compel defendants to return property which had been in the possession of receivers (and hence constructively in possession of the Court) but which the receivers, without authority, gave to defendants. *See Schumacher* v. *Beeler, supra,* 293 U.S. at 370 and n. 2. *Whitney* was thus a case where for substantive reasons both summary *and* plenary jurisdiction over the subject matter were conferred by the Bankruptcy Act; it does not in any way assert that where, solely for reasons of judicial

[33] The parenthetical comment in *Chase Nat'l Bank* v. *Lyford* that Section 23 relates "not to 'jurisdiction' but to venue", 147 F.2d at 277, apparently overlooked the Supreme Court's explicit rejection of that reading of Section 23 eleven years earlier in *Schumacher* v. *Beeler, supra,* 293 U.S. at 371. *See also Tenenbaum* v. *Walter E. Heller & Co.,* 308 F.Supp. 1085, 1086-1087 (S.D.N.Y. 1970).

economy, summary jurisdiction might exist with respect to a claim of the trustee simply because it is asserted as a counterclaim to a creditor's claim in the liquidation proceeding, the trustee can—in derogation of the very reason for implying such jurisdiction in the first place—assert his claim in a separate plenary action.

Consequently, the Trustee's basic error in arguing for his so-called "consent" jurisdiction lies in the fact that he simply ignores the clear distinction between this *plenary* action and whatever *summary* proceedings he might have commenced in the Weis liquidation proceeding by reason of Touche Ross' proofs of claim therein. Consequently, his entire argument is nothing more than a confusing hodgepodge of concepts purportedly applicable in summary proceedings, discussed on the patently erroneous assumption that those concepts automatically are applicable to separate *plenary* actions.

B. The Proofs of Claim Would Not Confer Jurisdiction Even In A Summary Proceeding

1. TOUCHE ROSS' CLAIMS AND THE TRUSTEE'S CLAIMS ARE "UNRELATED".—It is also clear that the filing of Touche Ross' proofs of claim would not have conferred jurisdiction over the Trustee's common law claims even if he had asserted them as counterclaims in a *summary* proceeding. This is because, as the District Court expressly found, Touche Ross' claims and the Trustee's claims are "unrelated" (410a; 428 F.Supp. at 492).

It is for reasons of judicial economy that courts have been willing to consider the act of filing a proof of claim as consent to counterclaims by the trustee, where the claim and counterclaim are "so closely related [that] it is unreasonable . . . to separate one from the other." *Continental Casualty Co.* v. *White,* 269 F.2d 213, 215 (4th

Cir. 1959). *See also Peters* v. *Lines,* 275 F.2d 919 (9th Cir. 1960) (creditor claimed damages for breach of contract; trustee permitted to counterclaim for breach of same contract).[34] Accordingly, it is well-established that the filing of a proof of claim will only confer summary jurisdiction as to claims by a trustee which involve preferences or voidable or fraudulent liens or transfers, or which arise out of the same transaction for which recovery is sought in the proofs of claim and are so intimately related to the original claims as to be compulsory counterclaims.[35] *See, e.g., Peters* v. *Lines, supra,* 275 F.2d at 925; *In re Behring & Behring,* 445 F.2d 1096, 1098 (5th Cir.),

[34] This prevents the trustee from having to present the same evidence twice, once before the bankruptcy judge to defend against the creditor's claim and once before the court with plenary jurisdiction to make his affirmative recovery. *See In re Farrell Publishing Co.,* 130 F.Supp. 449, 453 (S.D.N.Y. 1955) ("The same proof will be required in defending against [the creditor's] claim as is necessary in the proof of the trustee's counterclaim"); *Columbia Foundry Co.* v. *Lochner,* 179 F.2d 630, 633 (4th Cir. 1950) ("creditor must produce the same evidence to save his claim as he would to defeat an affirmative judgment against him on the counterclaim"). Moreover, once the bankruptcy judge adjudicates the creditor's claim, principles of collateral estoppel would prevent relitigation of some if not all of the issues in the trustee's closely related counterclaim, so that requiring the trustee to bring a separate plenary action against the claimant to litigate a matter already settled between them would be to exalt form over substance. *Cf. Katchen* v. *Landy,* 382 U.S. 323, 333-335 (1966). *See also Giffin* v. *Vought,* 175 F.2d 186, 189-190 (2d Cir. 1949).

[35] Since the summary jurisdiction of the bankruptcy judge abrogates the claimant's right to trial by jury which he would have if he had not filed a claim but rather abided the trustee's plenary suit, *Katchen* v. *Landy,* 382 U.S. 323, 336-340 (1966), a right normally entitled to great deference, *Beacon Theatres* v. *Westover,* 359 U.S. 500, 510-11 (1959) (right to jury trial lost "only under the most imperative circumstances"), courts have been very cautious in enlarging that jurisdiction. *See In re Behring & Behring, supra,* 445 F.2d at 1098-1099; *Gill* v. *Phillips,* 337 F.2d 258, 262-263 (5th Cir. 1964); *In re Carnell Constr. Corp.,* 424 F.2d 296, 298 (3d Cir.), *cert. denied,* 400 U.S. 828 (1970); *In re Beasley-Gilbert's, Inc.,* 285 F.Supp. 359, 363 (S.D. Ohio 1968); Ferguson, *The Consensual Basis of Subject-Matter Jurisdiction in Matters of Bankruptcy: Fact and Fiction,* 14 Rutgers L. Rev. 491, 493, 511 (1959).

cert. denied, 404 U.S. 991 (1971) ("The district court . . . held that the subject matter of the counterclaim was not so inextricably interwoven with the subject matter of the claim . . . as to be brought under the summary jurisdiction of the Bankruptcy court. We agree").[36] The relationship between claim and counterclaim required to confer consent jurisdiction is evident from *In re Behring & Behring, supra,* where the creditor filed a proof of claim alleging that it purchased cotton from the debtor which was not delivered. The trustee counterclaimed for alleged usurious interest paid to the creditor. The creditor moved to dismiss the counterclaim on the ground that the transactions which formed the basis for the counterclaim were entirely separate from those upon which the proof of claim was based. The trustee argued that the transactions were not discrete since his relationship with the creditor constituted a "continuing financing arrangement". 445 F.2d at 1098. The Fifth Circuit, rejecting the trustee's request

[36] *See also In re Carnell Constr. Corp., supra,* 424 F.2d at 298-299 (3d Cir. 1970) (bank claimed security interest in debtor's automobile; no jurisdiction over counterclaim regarding other loan of debtor which bank had set off against funds deposited with it); *In re Los Angeles Trust Deed & Mtge. Exch.,* 464 F.2d 1136, 1138-1139 (9th Cir.), *cert. denied,* 409 U.S. 1064 (1972) (creditors asserted claims with regard to parcels of land; *held:* no summary jurisdiction over counterclaims regarding other parcels); *In re Majestic Radio & Television Corp.,* 227 F.2d 152 (7th Cir. 1955), *cert. denied,* 350 U.S. 995 (1956) (creditors's claim for goods sold did not subject him to summary jurisdiction regarding breaches of fiduciary duty as director); *In re Supreme Meat Co.,* 73 F.R.D. 295 (E.D. Mo. 1976) (insuror's claim for premium under one policy did not subject him to summary jurisdiction of counterclaim for payment pursuant to prior policy); *In re Beasley-Gilbert's Inc., supra* (creditor filed claims for rent and under guaranty agreement; *held* not to have consented to summary jurisdiction over counterclaim under contract to purchase shares of stock). *See also Daniel* v. *Guaranty Trust Co.,* 285 U.S. 154 (1932); *Matter of Bankers Trust Co.,* 566 F.2d 1281, 1288-1289 (5th Cir. 1978); *Katchen* v. *Landy, supra,* 336 F.2d at 537; *Cherno* v. *Engine Air Service, Inc.,* 330 F.2d 191, 193 (2d Cir. 1964). These cases show that the Trustee errs in asserting that mere "overlapping" proof is sufficient (Tr. Br. 18).

to adopt a permissive counterclaim standard, found that "each transaction was a separate and severable agreement, and not contingent on any other transaction, past or future, between the parties." 445 F.2d at 1099.[37]

The Trustee's common law "causes of action" do not involve a preference or voidable transfer and do not arise out of the same transaction for which Touche Ross sought compensation in its proofs of claim. The Trustee here sues Touche Ross with respect to services in connection with various financial statements which were examined "as of May 26, 1972" (Comp. ¶ 24). In its proofs of claim, however, Touche Ross sought reimbursement for work which was performed after the examination of those financial statements, including services performed in or about April 1973. The complaint raises no issue whatsoever about the adequacy of the services covered by the proofs of claim, and there is no merit to the Trustee's

[37] The Trustee's cases (Tr. Br. 17-18) hold no differently. *Nortex Trading Corp.* v. *Newfield,* 311 F.2d 163 (2d Cir. 1962), involved a counterclaim for recovery of a preference. *Beldock* v. *Faberge, Inc.,* 4 Bank. Ct. Dec. 432 (S.D.N.Y. 1978), involved an alleged fraudulent transfer. *In re Farrell Publishing Corp., supra,* 130 F.Supp. at 452, defined "related claims" as those "arising out of the subject matter of the creditor's claim" and in fact applied the compulsory counterclaim standard. In *Chase Nat'l Bank* v. *Lyford,* 147 F.2d 273 (2d Cir. 1945), the bank had set off funds in the bankrupt's account against part of its claim, and the trustee's counterclaim challenged that set-off. *In re Seatrade Corp.,* 297 F.Supp. 577 (S.D.N.Y. 1969), held that a compulsory counterclaim standard was applicable; its comment that there appeared to be "no good reason" to bar permissive counterclaims is simply erroneous *dictum* (see also pp. 45-47, *infra*). *Alexander* v. *Hillman,* 296 U.S. 222 (1935), is of dubious authority since it involved equity receivership rather than bankruptcy, *see In re Majestic Radio & Television Corp., supra,* 227 F.2d at 156; *In re Behring & Behring, supra,* 445 F.2d at 1099, and no court has ever read that case as supporting implied consent to bankruptcy jurisdiction of unrelated counterclaims.

contention that the two distinct sets of services were substantively connected.[38]

It is significant that in seeking review by the Supreme Court of the bankruptcy jurisdiction issue in this case the Trustee frankly admitted that "the Trustee's and Touche Ross' claims . . . may not be closely related enough to satisfy a strict compulsory counterclaim standard". Cross-Petition for Certiorari at 12, *Redington* v. *Touche Ross & Co.*, 99 S.Ct. 3095 (1979). *See also* Trustee's Brief at 16 (acknowledging that a "compelling nexus between the claims" may be absent here). What the Trustee seeks here is simply to dilute the requirements recognized by the applicable cases. However, dilution of those requirements to the extent which would be required to sustain "consent"

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[38] The Trustee's cases (Tr. Br. 19-20 and n. 12) are not on point. The decision in *Goldberg* v. *Touche Ross & Co.*, summarized at CCH Fed. Sec. L. Rep. ¶95,759 (S.D.N.Y. 1976), holds that workpapers of a later audit are discoverable in a suit based on an earlier one because they "may lead to some evidentiary discoveries." This possiblity of relevance hardly establishes that claims based on two audits, one being the creditor's claim for payment for the later audit, the other being the Trustee's counterclaim for negligent performance of the earlier audit, are so interrelated that they ought to be litigated in a single proceeding. *Wilkin* v. *Dana R. Pickup & Co.*, 74 Misc.2d 1025, 347 N.Y.S.2d 122 (Sup.Ct. Alleghany County 1973), deals solely with the state statute of limitations for accountant's malpractice and does not purport to substantively join discrete transactions for purposes of determining whether counterclaims are compulsory counterclaims. *Fischer* v. *Kletz*, 266 F.Supp. 181 (S.D.N.Y. 1967), and *Bancroft* v. *Indemnity Ins. Co.*, 203 F.Supp. 49, 55 (W.D. Iowa), *aff'd*, 309 F.2d 959 (5th Cir. 1962), concern the duty to correct previous auditors' opinions upon later discovery that they are misleading. The Trustee has not alleged that Touche Ross discovered the frauds of the Weis Five in performing the accounting services for which the proofs of claim sought payment and then failed to reveal them. Hence, *Fischer* and *Bancroft* are inapposite. The Trustee also does not help his argument by asserting that one proof of claim is an "apparent priority claim" for administrative expense, since such claims are deemed "unrelated" to pre-bankruptcy claims asserted by a trustee. *Cherno* v. *Engine Air Service, Inc., supra,* 330 F.2d at 193; *see In re Park East Corp.*, 470 F.Supp. 147, 149-150 (S.D.N.Y. 1979); *cf. M'Eldowney* v. *Card,* 193 Fed. 475, 480-481 (E.D. Tenn. 1911).

jurisdiction of the Trustee's common law claims simply would make those requirements meaningless and, perhaps more importantly, would make illusory the judicial economies which supposedly justify the doctrine of jurisdiction by implied consent.

2. "CONSENT" JURISDICTION DOES NOT EXTEND TO ANY UNRELATED "MUTUAL" CLAIM.—Apparently recognizing the weakness of his contention that his claims satisfy the "relatedness" requirement, the Trustee argues (Tr. Br. 21-25) that such requirement should be abandoned, and that "consent" jurisdiction should extend to *any* "mutual" claim capable of being set-off under Section 68a of the Bankruptcy Act, 11 U.S.C. § 108a. The Trustee relies upon *Katchen* v. *Landy,* 382 U.S. 323 (1966), which held only that by submitting a claim in bankruptcy a creditor subjects himself to the bankruptcy court's summary jurisdiction to order the return of a voidable preference and which did not decide whether the same rule applied to other types of claims by a trustee, and upon *dictum* in *Conway* v. *Union Bank of Switzerland,* 204 F.2d 603, 607 (2d Cir. 1953). Such reliance is misplaced, because the courts have neither extended the *Katchen* rationale to any unrelated mutual claim by a trustee, nor followed the *dictum* in *Conway.*

There are good reasons for not extending the *Katchen* rationale to any unrelated "mutual" claim capable of being setoff under Section 68a. In the first place, "[i]t should be remembered that [Section] 68 constitutes merely a statutory recognition of an accepted doctrine, with exceptions thereto, and does not govern the question of jurisdiction of a court to give effect to the doctrine". 4 COLLIER ON BANKRUPTCY ¶ 68.02[1], at 854 (14th ed. 1978). Moreover, although in the *Katchen* situation the determination of whether a claimant has received a

voidable preference was a prerequisite to determining the size and allowability of his claim under Section 57g of the Bankruptcy Act, determination of "mutual" claims pursuant to Section 68a is not (as the Trustee incorrectly argues, Tr. Br. 23-24) such a prerequisite, because the provisions of Section 68a have been held to be "permissive rather than mandatory". *Cumberland Glass Manufacturing Co.* v. *De Witt & Co.*, 237 U.S. 447, 455 (1915).

The *Katchen* holding was premised expressly upon the need to make the bankruptcy laws "'inexpensive in [their] administration'" and "'to secure a prompt and effectual administration and settlement of the estate of all bankrupts within a limited period'". 382 U.S. at 328. However, to extend the *Katchen* rationale to any unrelated mutual claim would conflict with *Daniel* v. *Guaranty Trust Co.*, 285 U.S. 154 (1932), which rejected the contention that a creditor by filing a claim for reclamation of property "entered its general appearance and in effect consented to submit itself to summary proceedings . . . in respect of matters having no immediate relation to the claim which it had presented". *Id.* at 162. In *Daniel,* the Supreme Court found administrative needs not to be sufficiently compelling so as to require a creditor, as the price for filing a claim, to relinquish the procedural safeguards which would be available in a plenary action brought by the Trustee on his unrelated claims:

> "In practice such a rule might lead to unfortunate complications and deprive owners of property of fair opportunity to recover. The risk incident to a general appearance and consent to adjudication of claims of all kinds might easily deter where the right to recover is clear. Moreover, the choice would not be between tribunals merely, but between the ordinary processes in a plenary suit and a summary hearing. . . . We

> cannot conclude that the demand for speedy administration of bankrupt estates is enough to justify such a radical departure from ordinary procedure." 285 U.S. at 162.

Moreover, the Trustee cannot retain the jurisdictional basis recognized in *Katchen* and at the same time cure the obvious injustice to the creditor recognized in *Daniel* simply by commencing (as was done here) a separate federal plenary action. Although such a plenary action would eliminate the procedural disadvantages to the creditor of a summary proceeding, it also would eliminate the reasons of judicial economy upon which the *Katchen* rationale is premised. The *Katchen* holding thus simply cannot be extended, consistent with the concerns recognized in *Daniel* and other cases (see p. 41 n.35, *supra*), to any unrelated "mutual" claim asserted by the Trustee.

III

If The Order Of The District Court Is Reversed In Any Respect, Proceedings In This Action On The Trustee's Common Law Claims Should Be Stayed Pending Determination Of The State Court Action

It was unnecessary for Judge Wyatt to reach the issue of whether this action should be stayed pending determination of the State Court Action. However, if Judge Wyatt's order is reversed in any respect this Court can and should decide the issue and direct that this action be so stayed.[39] The Trustee's common law claims are exactly

[39] It would be appropriate for this Court to decide the issue because it is in as good a position to make such determination as is the District Court, *e.g., William B. Tanner Co., Inc.* v. *WIOO, Inc.*, 528 F.2d 262, 269 (3d Cir. 1975), and judicial economy would better be served by an immediate determination rather than a remand, *e.g., Smith* v. *Government of Virgin Islands*, 329 F.2d 135, 142 (3d Cir.

the same as his claims in the State Court Action and present issues of State law only. Such issues should properly be dealt with in the State Court Action, which was begun nearly ten months earlier than this action and in which discovery is now proceeding. It would be inappropriate to burden the Federal court and Touche Ross with this second action which would proceed full tilt along a parallel track.

The inherent power to grant the stay cannot be questioned. *E.g., Mottolese* v. *Kaufman*, 176 F.2d 301 (2d Cir. 1949). The complex of factors in the present situation is compelling to require that, if Judge Wyatt's order is reversed in any respect, proceedings on the Trustee's common law claims here should be stayed pending resolution of the State Court Action:

> (a) The complaint in this action is "a carbon copy" of the State complaint, involving the same parties and exactly the same claims, and staying this action would be in the interests of judicial economy and conservation of litigant resources. *See, e.g., Weiner* v. *Shearson, Hammill & Co.*, 521 F.2d 817, 821 (9th Cir. 1975); *Universal Gypsum of Georgia, Inc.* v. *American Cyanamid Co.*, 390 F.Supp. 824 (S.D.N.Y. 1975).

1964), particularly since the issue is procedural, *cf., e.g., Locke* v. *Bd. of Public Instruction*, 499 F.2d 359 (5th Cir. 1974); *Caldewell* v. *Craighead*, 432 F.2d 213, 216 (6th Cir. 1970). Although in its original decision in this case this Court chose to leave to the District Court on remand the question "whether to stay the federal action pending determination of the state action", 592 F.2d at 625 and n. 15, the changed circumstances resulting from the Supreme Court's reversal of the decision regarding the Section 17 federal claims warrants reconsideration by this Court of the stay question. The dismissal of the federal claims removes from consideration the factor of exclusive federal jurisdiction over federal claims asserted under the 1934 Act, and therefore makes the considerations militating in favor of a stay now even more compelling.

(b) Only the State Court Action can effectively dispose of all of the issues and determine the rights of all of the parties, because SIPC can continue as a co-plaintiff in the State Court Action only. *See, e.g., Witmar Salvage Corp.* v. *C. W. Blakeslee & Sons, Inc.*, 308 F.Supp. 395 (S.D.N.Y. 1969); *cf. Chintala* v. *Diamond Reo Trucks Inc.*, 393 F.Supp. 1392, 1394 (E.D. Pa. 1975); *Nigro* v. *Blumberg*, 373 F.Supp. 1206, 1213 (E.D. Pa. 1974).

(c) "[T]he actions both here and in the state court turn exclusively upon issues of New York law .... [S]uch issues are more appropriately litigated in the New York courts where an authoritative construction of New York law can be obtained." *Universal Gypsum of Georgia, Inc.* v. *American Cyanamid Co., supra*, 390 F.Supp. at 827-828; *see, e.g., Clifton Park Manor, Section One, Inc.* v. *Mason*, 137 F.Supp. 324 (D. Del. 1955); *cf. Commerce Oil Refining Corp.* v. *Miner*, 303 F.2d 125 (5th Cir. 1962).

(d) The Trustee's prosecution of two actions would needlessly burden Touche Ross and the Federal court. A "litigant is entitled to his day in one court, but not in two". *Rosenfeld* v. *Black*, 445 F.2d 1337, 1341 n.5 (2d Cir. 1971).

(e) The State Court Action was earlier-commenced and already is proceeding, and the Trustee's prosecution of a second action in Federal court would be not only wasteful but would be fraught with the serious potential for abuse. *See, e.g., Semmes Motors, Inc.* v. *Ford Motor Co.*, 429 F. 2d 1197, 1203 (2d Cir. 1970) ("[C]ases where the same party is plaintiff in both actions would entail the danger that plaintiffs may engage in forum shopping

or, more accurately, judge shopping. When they see a storm bre' ing in the first court, they may try to weigh anchor and set sail for the hopefully more favorable waters of another district . . . . [W]hen the same party is plaintiff in both actions, the instances where the second court should go forward despite the protests of a party to the first action where full justice can be done, should be rare indeed").

CONCLUSION

For the foregoing reasons, the order and judgment appealed from should be affirmed.

Respectfully submitted,

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